

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

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NICHOLAS COPPOLA,

Plaintiff,

-against-

MEMORANDUM & ORDER

APPLIED ELECTRIC CORP. and
LAWRENCE HERMAN,

98 Cv. 3149

Defendants.

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GLASSER, United States District Judge:

BACKGROUND

The following allegations are assumed to be true for purposes of this motion:

Plaintiff Nicholas Coppola was an employee of defendant Applied Electric Corporation ("Applied"). Defendant Lawrence Herman ("Herman") is the President, CEO, founder, and majority shareholder of Applied.

In October 1993, plaintiff and Herman entered into an oral agreement whereby plaintiff would take a reduction in his hourly wage compensation and the reduction would be credited toward plaintiff's purchase of 10% of Applied stock. Pursuant to the terms of this agreement, plaintiff worked 35 hours or more per week from October 1993 until December 1994. He was paid for approximately 14 hours per week. The remainder of the compensation went to Herman on behalf of plaintiff to purchase the 10% interest in Applied. Through this arrangement, plaintiff paid approximately \$84,000 to Herman.

In September 16, 1994, pursuant to a shareholder agreement, plaintiff became the Vice

President of Applied. On October 19, 1995 Herman sent a letter to plaintiff, which stated: "I . . . have approved the transfer to you of ten percent (10%) of the outstanding common stock of 'AEC' . . . pursuant to my commitment to you . . . the issuance shall be forthcoming." Although plaintiff requested on numerous occasions that Herman deliver the actual stock certificates to him, no such certificates were ever forthcoming.

In the summer of 1995, the relationship between plaintiff and Herman began to deteriorate because of personal differences. Plaintiff then resigned from Applied on December 16, 1996, "under circumstances which constitute constructive discharge."

In a letter dated February 19, 1997, a shareholder meeting was called by Herman for March 8, 1997. The March 8th meeting resulted in the termination of plaintiff's ownership interest in Applied by the sole vote of Herman, who owned the remaining 90% of the stock.

Applied's shareholder's agreement provided for compensation for terminated shareholders. For shareholders terminated without cause, Applied was obligated to pay that shareholder the value of the stock that he owned within 180 days from the date of termination. However, when a shareholder is terminated "for cause" the shareholder agreement provides for a less lucrative buy-out scheme. When the relationship between Hermann and plaintiff began to deteriorate, Herman made false allegations of impropriety in order to terminate plaintiff as a shareholder under the less lucrative "for cause" buyout scheme.

Pursuant to the shareholder agreement, payment of plaintiff's equity interest was due 180 days after the March 1997 shareholder meeting, which would be in September 1997. To date, plaintiff has not received any payment for his 10% interest in Applied. Herman now claims that plaintiff never paid any consideration for his 10% interest and refuses to compensate plaintiff for

these shares.

Plaintiff commenced this lawsuit in April of 1998, alleging a violation of Section 10(b) of the Securities Exchange Act of 1943, 15 U.S.C. ¶ 78(j)(b) and Rule 10b-5 promulgated thereunder, 17 C.F.R. §§ 240.10b-5; breach of fiduciary duty; and breach of good faith and fair dealing. Plaintiff also requests an accounting of the corporate assets of Applied.

Defendants now move to dismiss plaintiff's complaint, asserting that the federal cause of action fails to state a claim under Fed. R. Civ. P. 12(b)(6). Thus, since the remaining claims are based on state law, the complaint should be dismissed in its entirety.

DISCUSSION

Legal Standard for a Motion to Dismiss for Failure to State a Claim

On a motion to dismiss, the factual allegations of the complaint must be accepted as true, and the complaint must be liberally construed and its allegations considered in the light most favorable to plaintiffs. Morin v. Trupin, 711 F. Supp. 97, 103 (S.D.N.Y. 1989) (citing Dwyer v. Regan, 777 F.2d 825, 828-29 (2d Cir. 1985) and Scheuer v. Rhodes, 416 U.S. 232, 236 (1974)). "A motion to dismiss will be granted only if it appears to be certain that the plaintiff is entitled to no relief under any set of facts which could be proved in support of the claim made." Id. (citing Conley v. Gibson, 355 U.S. 41, 45-46 (1957)). "A motion to dismiss is addressed solely to the face of the pleadings, and '[t]he court's function . . . is not to weigh the evidence that might be presented at trial but merely to determine whether the complaint itself is legally sufficient.'" Tinlee Enterprises, Inc. v. Aetna Casualty & Surety Co., 834 F. Supp. 605, 607 (E.D.N.Y. 1993) (quoting Goldman v. Belden, 754 F.2d 1059, 1067 (2d Cir. 1985)).

Failure to Sufficiently Plead a Violation of the Federal Securities Law

Section 10(b) of the Securities Exchange Act of 1943, 15, § 78j(b) of the United States

Codes states:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —

(b) To use or employ, in connection with the purchase or sale of any securities registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5 provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statement made, in light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

The essential elements of a claim under these provisions are (1) damage to plaintiff, (2) caused by reliance on defendant's misrepresentations or omissions of material facts, or on a scheme by defendant to defraud, (3) made with an intent to deceive, manipulate, or defraud (scienter), (4) in connection with the purchase or sale of securities, and (5) furthered by defendant's use of the mails or any facility of a national securities exchange. Lloyd v. Industrial Bio-Test Laboratories, Inc., 454 F. Supp. 807, 810 (S.D.N.Y. 1978). Defendants argue that

plaintiff has not alleged a violation of the securities law because he has not alleged any misrepresentation regarding the fundamental nature of the securities themselves. Plaintiff, in turn, claims that he has indeed sufficiently pleaded all of the elements necessary to establish a securities violation.

The Supreme Court, in Santa Fe Industries, Inc. v. Green, 430 U.S. 462, 477-78 (1977), enunciated the principle that a court should be reluctant to imply a 10b-5 cause of action for wrongs that do not fall within Section 10(b)'s fundamental purpose of requiring full and fair disclosure to participants in securities transactions of information that would be useful to them in deciding whether to buy or sell securities. A "claim of fraud and fiduciary breach . . . states a cause of action under any part of Rule 10b-5 only if the conduct alleged can be fairly viewed as 'manipulative or deceptive' within the meaning of the statute." Sante Fe, 430 U.S. at 473-74 (emphasis added).

"Under the law of this Circuit, in order to be actionable under § 10(b) and Rule 10b-5, material misrepresentations or omissions must pertain to the securities themselves." Bohicchio v. Smith Barney, Harris, Upham, and Co., Inc., 647 F. Supp. 1426, 1429 (S.D.N.Y. 1986). As the United States Court of Appeals for the Second Circuit explained in Chemical Bank v. Arthur Anderson & Co., 726 F.2d 930, 943 (2d Cir. 1984):

The purpose of § 10(b) and Rule 10b-5 is to protect persons who are deceived in securities transactions — to make sure that buyers of securities get what they think they are getting and that sellers of securities are not tricked into parting with something for a price known to the buyer to be inadequate or for a consideration known to the buyer not to be what it purports to be.

"The misrepresentation must relate to the securities alleged to satisfy the purchase and sale requirement, and not just to the transaction in its entirety." Crummere v. Smith Barney, 624 F.

Supp. 751, 755 (S.D.N.Y. 1985). See also Kearney v. Prudential-Bache Securities, Inc., 701 F. Supp. 416, 424 (S.D.N.Y. 1988) (“The ‘in connection with’ requirement mandates that the alleged fraud concern the fundamental nature of the [securities]: namely, characteristics and attributes that would induce an investor to buy or sell the particular [securities.]”).

Here, what plaintiff has alleged is not securities fraud. While it may be true that “[b]ut for the representation of Herman that the funds would be credited towards [the acquisition of] plaintiff’s 10% in Applied, plaintiff would not have invested,” plaintiff has not alleged that Herman told him anything at all that was inaccurate about the nature of the securities themselves. As in Pross v. Katz, 784 F.2d 455, 459 (2d Cir. 1986), “[t]he complaint here alleges no more than a conversion of property that happened to involve securities. [The Court] is unwilling to extend the reach of the securities laws to every conversion or theft of security.” Simply the fact that the converted property comprises securities does not transform plaintiff’s claim of conversion to one for securities fraud. Thus, plaintiff’s claim of a violation of section 10(b) of the Exchange Act and SEC Rule 10b-5 is dismissed.¹

Pendent State Law Claims

Because plaintiff’s federal claim is dismissed, pendent jurisdiction will not be exercised over its state common law claims. Although a court’s exercise of pendent jurisdiction is discretionary, “a court should decline to exercise jurisdiction over state-law claims when it dismisses the federal claims prior to trial.” Pitchell v. Callan, 13 F.3d 545, 549 (2d Cir. 1994).

¹Defendants also argue that plaintiff’s securities fraud claim is time barred and that it was insufficiently pled under Fed. R. Civ. P. 9(b). Since 10(b) does not apply to the present action, these arguments need not be addressed.

Plaintiff's state law claims are, therefore, also dismissed.

CONCLUSION

For the foregoing reasons, defendants' motion for summary judgment is granted in its entirety.

SO ORDERED ✓

Dated: July 1st, 1998
Brooklyn, New York



I. Leo Glasser, U.S.D.J.

A copy of the foregoing Order was this day sent to:

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